

**ADEPT**  
**Socioeconomic Commentaries**

July-October 2005

**The consumer price index (CPI) dropped by 0.8 percent in June, compared with May 2005**, mainly due to the season decline of prices of food products. We said in a previous commentary that significant declines of prices of food products, as well as deflation are registered at summer. **Inflation in June validated our forecasts** and a deflation was registered for the first time this year. **A 4.7 percent cumulative annual inflation rate was recorded in the first half of this year.**

However, the optimistic estimates of the Government and National Bank of Moldova for this year indicate a 8-10 percent inflation rate. In addition, officials of the International Monetary Fund said, while on a working mission to Moldova two weeks ago, that the National Bank will succeed to maintain the inflation at nine percent and even at a lower level. **However, I have some reservations over optimism of authorities and forecasts of IMF high ranking officials.** I will explain further on why inflation this year will not probably fit the limits forecasted by authorities, of course, if they do not falsify the official figures.

**The forecasted inflation could be "overturned" under incidence of several factors**, including:

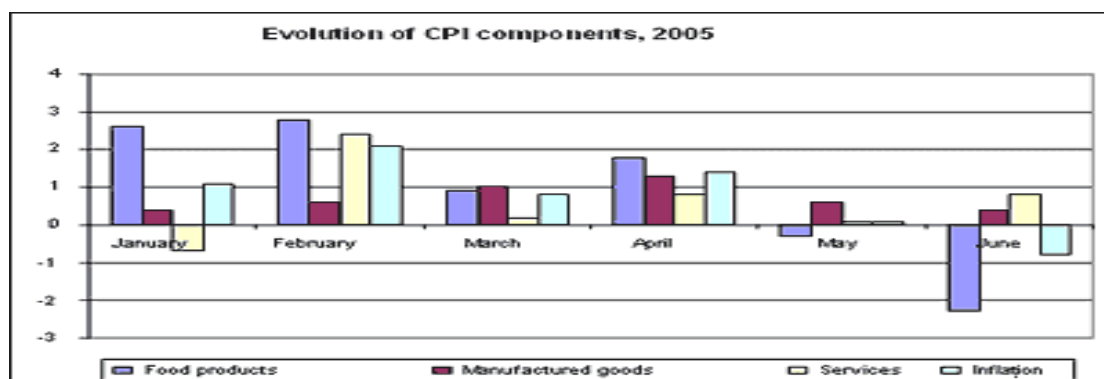
- **permanently bad situation** (registered in the latest period) of **agriculture sector**, whose negative productive results (in many branches of this sector) were observed in higher prices, particularly of food products (namely the CPI for food products rose the most in January-May 2005);
- **growth of production costs** (salaries, acquisition of raw material, etc.) **in the industrial sector**. In addition, many domestic enterprises which are dependent on imported raw materials had to pay higher prices for them;
- **higher consumption demand financed both from internal sources** (salary rise, reduction of taxes, etc.), and external sources (massive currency remittances from abroad);
- **influence of administrative factors** such as growth of some tariffs for public services, public transportation, etc.
- **high prices of imported oil products** due to their global rise (importers of fuels are tempted again to review the prices posted by filling stations);
- **potential rise of natural gas prices** supplied by Russian concern *Gazprom* and their supply to enterprises and dwelling sector for much higher tariffs (recently Russia's State Duma has unanimously approved an appeal to the cabinet of ministers, in which it seeks higher tariffs for natural gas supplied to some states in the CIS and the Baltics, including Moldova).

I do not see a lower inflation than 10 percent for late 2005, if taking into account these figures and factors. Although the internal context envisages the economic growth and the economic environment is positive in general, there are high risks for 2005, which especially come from the foreign deficit (trade and current account deficit) and inflation area.

The appreciation of leu vs main reference currencies is preferable from macroeconomic point of view under pressure of speculations on exchange rate. **The curve of prices presents two inflationary jumps this year**, mainly generated by rise of prices of energy agents (electricity, natural gas), and oil products (gasoline, Diesel oil, etc.). The **first** monthly peak of inflation **was registered in April-May**, and we will "experience" **the second one** at the end of this year, **in November-December**.

Many persons could wonder: how can the government, for example, keep the inflation within established limits on one hand, and increase the prices of energy agents on the other hand? It is hard enough, isn't it? Yes, it is a big provocation, but we should probably regard the general economic situation in Moldova. **Reduction of income tax** and corporate profit tax, **rise of salaries** for several categories of workers, as well as **growth of pensions** starting April 1, 2005 brought and will bring additional money to people. This **would help them, at least partially, to bear potential higher energy prices more easily**.

Dangers for the 10-percent annual inflation target do not come only from potential rises of natural gas and electricity prices. **Being part of many consumer prices**, the price of fuels is also a serious threat. As a general rule, higher prices of fuels (oil products, natural gas) **will create economic and psychological premises needed for rise of prices of most of food products and manufactured goods**.



Source: *the National Bureau for Statistics (BNS)*

## **Transnistria Economy: Regional Dimension**

Galina Selari, July 29, 2005

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*Democracy and governing in Moldova  
e-journal, III year, no. 55, July 4-29, 2005*

The new challenges, events and decisions of the last years (2000-2005) that brought about worsening economic relations between Moldova and Transnistria (so-called "economic blockade", boosting privatization process and its legitimacy, autonomy of the region's infrastructure), highlight the economic component of the "Transdnistrian issue". And this is the very component which confers Transdnistrian conflict a regional dimension.

Noteworthy, in the last 15 years that is after 1990 Moldovan-Transdnistrian relations have tittered between two extremes - from "do whatever you want and trade with whoever you want" (including the use of customs stamps of the Republic of Moldova for legalization of TMR's external trade) to continuous pressing and barriers to the export-import of Transdnistrian enterprises. The economic confrontation between Moldova-Transdnistria commenced with Moldova joining WTO in 2001, followed by withdrawal of customs stamps. On the other hand, prospective adherence to the same organisation in 2005 of Russia and Ukraine - both guarantor states and Moldova's and Transdnistria's main trade partners - is considered to be a factor that might speed up reaching a reasonable consensus in settling Transdnistrian conflict. Another important aspect is that Moldova, Russia and Ukraine are included in the EU "new neighbourhood policy" and are member states of regional organizations such as Black Sea Economic Cooperation, Central European Initiative (Moldova and Ukraine).

That is why not only Republic of Moldova and Transnistria, but also Ukraine, Russia, European Union and USA should be interested in a faster and constructive resolution of the "Transdnistrian issue". Another evidence is the fact that currently Transdnistria trades with almost all CIS countries, the majority of European Union countries and even with Australia and New Zealand, and African countries (Algeria, Egypt, Tunisia, Morocco, and South Africa). The "secessionist" region succeeded in establishing quite stable and reliable relations not only with partners from CIS, but also with European countries (Germany, Italy and Romania). At the same time they came up with such mechanisms that foreign factors or barriers practically does not affect the bilateral relations with those countries.

In the last five years Transdnistria made a "breakthrough" in exports to Europe, primarily EU, which account for a big share of Transdnistria's exports: 2000 - 19.3%, 2001 - 23.4%, 2002 - 34.0%, 2003 - 32.2% and 2004 - 33.3%. Whereas Moldovan export to EU countries was smaller over the same period: 2000 - 21.7%, 2001 - 21.3%, 2002 - 22.3%, 2003 - 26.7% and 2004 - 30.1%. Of course, one should take into account the differences in the structure of Moldova's export (70% - foodstuffs and light industry goods) compared to Transnistria's one (metal-roll - about 60%, machinery and equipment, textile).

Geopolitical position of Transdnistria (closeness to the Balkans, Danube and Odessa - Ilyichevsk, the largest commercial port of the Black Sea) sets it as a transit region, and all countries of the region have their own interest in this transit corridor, its economic component: Russia - to use advantages of transit through the region of natural gas and electricity (including the one produced by Moldovan power station, now owned by "Nordic Oy/RAO EES), Ukraine - highly profitable and export-oriented production of metal-roll (from 2004 the Austrian-Ukrainian Hares Group is the owner of Moldovan Metallurgical Works - MMZ); the European Union - IX Trans-European transportation corridor is scheduled to run via Dubasari and Chisinau. Yet another sensitive issue, both economically and politically is the privatisation process in Transdnistria as more and more foreign and domestic (Transdnistrian) investors are attracted.

The growing number of foreign companies - the new owners of enterprises in Transnistria - introduces a new and quite important element in the diversity of Transdnistrian situation, and its importance would only grow in time. Currently it is the foreign investors who contribute to restoring economic unity of the two sub-regions of Moldova, namely "Aroma" Trade House (Russia), "Saliut" company (Russia) - instrument-making industry and WJ Group of companies (USA) - production of vegetable oil.

Note: in Transnistria out of 37 enterprises - "large-scale" privatisation - 11 are owned by external investors, out of which Russia (4), EU Member-States (4) and USA (2)<sup>1</sup>.

For reasons far from economic ones, Moldovan business society *officially* does not take part in this privatization and is "satisfied" with status of an observer <sup>2</sup>. Meanwhile, participation in privatisation processes by businesses from the right bank of Dniestr might boost economic reintegration since it can:

- promote free circulation of capital,
- make Moldova more attractive both for Transdnistrian population (Moldova invests rather than set its hands on the most profitable enterprises of the left bank<sup>3</sup>) and for foreign investors,
- opportunity for the return of Moldovan business and goods to Transdnistrian market,
- areas where shadow and criminal business schemes might be used are shrinking as is the scale of shadow economy as whole.

Noteworthy, presence of foreign investors in Transnistria takes the "customs conflict" out of the local context: difficult export-import affect all the businesses from the left of Dniester.

Another important aspect, Transnistria's attempts to divide and form an infrastructure "of its own", independent from that of RM: transportation, including railways, telecommunications, natural gas supply, etc.

That approach is mutually inefficient for both parties: extremely limited financial resources (Moldova is the poorest country of Europe) are used to "neutralize" the losses of mutual estrangement. Moldova is urgently reconstructing the railway link Revaca - Cainari, while Transnistria tries to restore traffic along "its" part of the

railroad and intends to include the railway in the state privatization programme. Meanwhile, state company "Railways of Moldova" ended 2004 with losses, and plans to adjust to the new situation by the end of this year. The national railway company of Ukraine, in its turn, loses millions of USD due to impossibility to use the border railway station Cuciurgan (Ukraine invested more than USD 2 million into its reconstruction). It is estimated that Transdnistrian budget would also incur losses of USD 2 million.

Besides those "local losses", most importantly is that traditional transit corridors are affected. Redirecting goods and passengers flows around Transdnistria not only make transit time longer (additional 500 km.) but could have a negative influence on transit potential of Moldova as whole. And the first step is already done: starting from March 1, 2004 the Kiev-Chernovti train won't enter the Moldovan territory. And one may also expect that other trains from CIS countries will go to Danube-Carpathians region and Balkans through Chop to Trans-Carpathian rather than Tiraspol-Djurdjulesti.

It is our belief that too a large extend at this crucial stage in the settlement of "Transdnistrian issue" *neglecting its economic component would only further postpone finding a mutually acceptable political settlement of the problem. That is why* it will be vitally important to take into account economic interests both of the Republic of Moldova and Transnistria, as well as of their partners while formulating and making political decisions. International experts are reaching the same conclusion: *"A reconstruction program for Transdnistria to be implemented after an agreement on final settlement is concluded, should be elaborated in detail and put forward for public debates. Moreover, Transdnistrians should be confident that they would continue their legal business operations and that the region would keep its property and a fair share of the revenues collected on its territory."*<sup>1</sup>

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<sup>1</sup> Newspaper "În viața noastră", 03.06.2005

<sup>2</sup> According to "Olvia-Press" (16.11.2004) 100% of the company shares of meat factory (Tiraspol) amounted to 456 thousand rub. TMR were sold to foreign investor JSC "Lendergroup" and there is an information that it is registered in the Republic of Moldova

<sup>3</sup> Moldova: No Quick Fix, International Crisis Group Europe Report #147, Brussels 12.08.2003, p. 28

<sup>4</sup> Ibidem, p. 27

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**Unemployment: a curse of transition**

Valeriu Prohnitchi, September 1, 2005

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*Democracy and governing in Moldova*  
*e-journal, III year, no. 56, August 1-31, 2005*

**Why to analyze unemployment**

The analysis of unemployment is part of the most difficult and responsible sides of the economic analysis. The explanation is that human fates and tragedies are behind statistics, rather than an empty economic phenomenon. The governments no matter how liberal they are and how insignificant is their intervention in the game of the economic forces on market, they must do their best to find solutions to joblessness. Many arguments support a careful monitoring of this phenomenon and favor an active employment policy.

Firstly, to be jobless is a social condition, one of the class, rather than a simple economic rating of the individual. This is a label that has a deep psychological impact on whom it concerns. Unemployment becomes a risk factor which may make a human take a criminal way, get addicted to alcohol, or be violent in his family. We often observe such negative influences in Moldova.

Secondly, unemployment is a grave form of spending of resources needed to ensure an economic growth and to raise large incomes. In turn, the growth must generate new jobs, improving living standards for large masses of people and reducing unfairness in distributing incomes. If this does not happen, a relatively small segment of people benefits from created incomes. We face such a situation in Moldova, which is worsened because 40 percent of population is employed or subsisting from agricultural activities which bring very small incomes.

Thirdly, the unemployment may be very expensive in political terms, with many governments in the world failing reelection after unemployment got serious sizes.

**Statistics and unemployment**

The analysis of unemployment in Moldova becomes complicated because of incomplete statistics. The economically developed countries calculate the joblessness rate on basis of data registered by employment offices. This method does not work in Moldova because most of citizens do not hurry up to get registered with employment offices. These offices registered 27,000 jobless citizens in the 2nd quarter of this year, though the Employment Investigation in Moldova indicated almost 96,000 job seekers. This lack of interest should give some food for thought for politicians. It demonstrates either the inefficiency of the governmental policy on assistance of job seekers, or the distrust of the citizen and the fact that he does not expect anything from the state, with the employment office being a creature of the state authority under these conditions.

The information on joblessness rate was collected on basis of the labor investigation, and this means that the statistics office must "catch" the job seeker. If the citizen has a temporary job, even of a couple of days or weeks (as for example, he is hired by his neighbor by the day for agricultural works), he will not be found at home to fill up the questionnaire. In compliance with the definition recommended by the International Labor Bureau, a job seeker must: 1) have no job; 2) be ready to begin working within two weeks, if he immediately finds a job; 3) seek a job. This is an ample definition, and a better one cannot be imagined. However, the citizen in our country can have a job, but he may not earn an efficient salary for his work (an aberrant phenomenon, but available in European countries). Statistics show that employers had arrears worth 126 million Lei on salary payments in July 2005.

Also, citizens may be unable to start working within two weeks and may not actively seek a job in Moldova, where salaries are very low and even miserable in sectors such as agriculture. Instead, the citizen would rather actively search a tourism agency to help him immigrate abroad, to countries with higher salaries.

### **Emigration and unemployment**

Unemployment in Moldova is in a deep correlation with emigration of labor force abroad. In other terms, emigration is a factor which reduces pressures on labor market and substantially declines the joblessness rate. It is not hard to imagine what social revolts would take place if for certain reasons citizens were prohibited to emigrate.

In 2004, the National Bureau for Statistics (BNS) identified 345,000 people who have left for work abroad<sup>1</sup>. Let's suppose that they were in the country and added to the number of economically active people. Existing studies show that one third of Moldovan emigrants had no jobs before leaving the country<sup>2</sup>. Thus, one may assume that 115,000 out of 345,000 citizens who would not emigrate were job seekers. Using the new data, the unemployment rate in 2004 would be 13 percent, not 8 percent. However, half or even more of potential emigrants would become jobless sooner or later, increasing the number of job seekers.

Even more, emigration is followed by remittances from abroad which allow people who remain at home to refuse low-paid jobs. The number of job seekers, even of low-paid jobs, would grow, if the emigration did not exist, producing a significant rise of unemployment rate.

### **Unemployment and youth**

Statistics say that unemployment especially affects youth aged between 15 and 29. They form the largest group of job seekers accounting for 36-percent. They are not accidentally the largest category among emigrants. Youths between 20 and 24 run the highest risk to be jobless, with most of them being graduates from higher institutions. The incidence of unemployment in this age category rose from 15.3 percent in 2002 up to 25.2 percent in 2004. Considering the trends registered in the first two quarters of this year, this indicator will surge up to 30 percent in 2005. The situation is very



grave among young men from cities, as they run a higher risk not to find a normal job than the average per country.

More than 20,000 students graduated from professional, secondary and higher education institutions in 2004. We do not know how many of them were hired, but it is well-known that employers prefer experienced specialists instead of fresh graduates. The government makes some timid attempts to encourage the employment of young graduates, but the resources allocated for this purpose are too small and this policy envisages only the budget-financed students<sup>3</sup>.

The trends demonstrated by indicators of labor market and inefficiency of governmental policy on employment say that emigration will be fueled in continuation and may even grow on account of youths who are pessimistic to get employed in the country. Recent statistics say that emigration does not show any reverse signs. BNS identified in the 2nd quarter of 2005 more than 380,000 people who have left the country, and we may expect that this number exceed 400,000 persons by late 2005.

The national economy is unable to offer jobs to people who are part of the economically active population category. If a job is available, the salary makes the worker leave his employer shortly. Moldova organized a number of job fairs for youths in April-June 2005, with a public official saying on this occasion that the average salary offered at fairs accounted for 900 Lei. Such an earning is absolutely unacceptable for graduates from higher education institutions, as many of them have invested hard 4-5 years in their knowledge.

Graduates also face other problems. Firstly, the quality of knowledge and skills depends on requirements of managers. Graduates are theoretically prepared well and sometimes very well, but they lack any experience. Secondly, the higher education system offers specialties which reflect the current demand for "prestigious" faculties: 22 percent of graduates come from law faculties, 21 percent from economics faculties, 12 percent from philology and foreign languages. However, this distribution does not respond to the current demand on labor market, which needs more and more mechanical engineers, IT specialists and construction workers. Most of young lawyers, economists and translators will either have to accept offers which does not match their education, or will leave for abroad. There are few countries which afford the luxury to train job seekers and emigrants with higher education like Moldova.

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<sup>1</sup> See "Active, Employed Population and Unemployment in the 2nd Quarter of 2005", communication, August 2005, BNS

<sup>2</sup> Ghencea Boris and Gudumac Igor, "Labor Migration and Remittances in the Republic of Moldova", sponsored by AMM and Moldova-Soros Foundation, March 14, 2004

<sup>3</sup> See the June 20, 2005 Government Decision # 594 on approval of procedures aimed to encourage employers to hire state-financed graduates from educational institutions, Monitorul Oficial # 89-91 (1688-1690)

## **Real estate market in a deadlock**

Iurie Gotisan, September 12, 2005

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*Democracy and governing in Moldova  
e-journal, III year, no. 57, August 31 - September 12, 2005*

Since 2001 the prices on real estate surged 3.5 times. For instance one bedroom apartment was worth an average \$5,500 USD back in 2001, while now it goes for no less than 17,000 USD. Even if the real estate market has registered stagnation after a boom in the recent years, experts reckon a 15-20% price hike on real estate is inevitable by the end of the year.

It's hard to trace the trends on real estate market in Moldova. In Chisinau, for instance, prices on different types of estate in different districts should be available in the statistics released by the notaries. Albeit they levy huge fees on real estate transactions, notaries declare meager fees and no law has so far made them release clear data on the real estate price. The only reliable indicator in use is the "call" price, that is, the price the real estate agency or a seller asks for.

Sluggish period was registered on real estate transactions, and this largely due to skyrocketed prices. Albeit the current supply meets the demand by over 50%, the prices remain high. On top of that, the demand is low due to lack of funding. The prices shot up enormously, while great many of those who would opt for mortgage, cannot apply for it in banks as their income does not qualify. Moreover, there are some psychological factors that shape the market, namely speculators.

At the same time the last three years saw a boom in construction, which partly explains the surged demand for apartments. On the other hand, the high interest rates set by banks for mortgage stymie even further the stagnating market. What slows down the market is the high prices called by the sellers, encouraged by real-estate agencies earning heavy money on those transactions, prices that are far beyond what the potential buyers could afford.

A solution to revive the market is to boost construction of new apartment blocs. However, the move raises some problems as well, as the land prices are surging. Therefore, it is no longer profitable to build houses, as the costs exceed by far the prices dictated by the markets. On the other hand, the high prices on land make the construction of apartment blocks profitable.

Still, the real estate boom hit hard the poor and young families that cannot afford a house. Mortgage might be a solution, promoted by efficient housing policies, however this market is not yet fully-fledged in Moldova. For now, the only problem with the mortgages is the limited offer of new apartments, which are rather expensive.

On top of that, people are wary when it comes to blocks under construction. There are offers for apartments worth 25,000 Euro. You first sign a pre-contract for that amount, mind you the price is only a tentative one, when the construction is over you'll have to take more money out of your pockets than initially planned.

Local banks may want to be more active in providing mortgage credits at an interest rate no higher than 10% for at least 25 years. As the banks have huge amounts in their coffers, such a move might boost construction of new housing. Yet another solution is for the state to subsidize a part of the interest rate, quite luring for those wishing to buy housing. Such schemes are very popular in Europe. Furthermore, European Bank for Reconstruction and Development opened quiet cheap credit lines for several local commercial banks, funds that they might want to use for financing construction of new housing.

## **GDP is on the rise despite unfavorable circumstances**

Iurie Gotisan, September 26, 2005

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*Democracy and governing in Moldova  
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Last week official statistics released data on the economic growth, i.e. an 8.6% surge in the first half of the year. Giving the industrial growth, good harvest and growing exports, the economic growth for the year might equal or even exceed 2004 one.

This time again, consumption fueled the economic growth - which is not exactly a bad thing. Only in this case, the pace of credit growth, especially the consumption one, runs counter to economy's ability to promptly react to surging demand, and therefore massive imports shake the trade balance. Areas which should be boosted by credits, namely manufacturing, are very slow.

At the same time, evolution of oil price on the international markets, which hit a record high level skyrocketed the oil prices on the Moldovan market. As it is included in production costs of many consumer goods, surging oil prices pose a threat for the economic growth that consequently might cause a downturn in the economic growth. Furthermore, trade deficit that reached 600 million USD over January - July 2005, record high since 1001, might also influence the economic growth.

Flagging profit margins of the exporters - due to rising production costs, fuel price and appreciation of the national currency - coupled with dropping investments in exporting industry, might set the budget deficit to soar exceeding 30% of the GDP by the end of the year, i.e. go over 1 billion USD. Under those circumstances, one may well expect an outflow of foreign capital and Leu depreciation. This is only a scenario, however it should not be ruled out.

Nevertheless, statistically speaking this year might as well report high economic growth; but let's better wait until the end of the year.

As for inflation, it registered 3.7% over January - August, perfectly falling within the Government 8-10% forecast. However, one should not forget about the deflation registered over the summer, traditional for that period of the year. The prices on food have dropped thanks to the good harvest this year and great supply as Russia banned the import of fruits, vegetables and meat from Moldova.

Still, this year is different, especially because of skyrocketed oil prices. It is also expected that prices on natural gas will rise, especially after so many declarations made by the Russian officials in this respect. Accordingly, inflation is set to soar. If this happens, it would be largely due to skyrocketed prices on fuel, electricity and high production costs.

Firstly, heating price would be likely adjusted (raised) to the rising oil prices once it is supplied to the consumers. This adjustment would be definitely recorded by the statistics. Rising oil prices are also likely to set the electricity price to soar. Moldelectrica already announced that it would raise the price for transporting energy.

Oil price fluctuations on the international market is yet another cause of concern when it comes to inflation rate. And this largely due to the fact that oil price is reflected in all the prices considered when estimating inflation rate. It is known-for-a-fact that domestic prices adjust faster to the international prices, than the domestic salaries do.

Furthermore, rising production costs, fueled by growing salaries, might also shape inflation. For the National Bank seeking to ensure the price stability the situation is not exactly favorable.

Having said that, the economy would slow down, especially if there would be other unfavorable circumstances to come.

## **"Economic competitiveness is a heavy burden for Moldova"**

Ion Basiul, October 11, 2005

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*Democracy and governing in Moldova  
e-journal, III year, no. 59, September 27 - October 12, 2005*

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According to an economic competitiveness top drafted on basis of the annual report of the World Economic Forum, organiser of the popular forum in Davos, Moldova is ranked the 82nd place among 117 states included in the top. Besides this evaluation undertaken on basis of an indicator, which measures the medium- and long-term (5-8 years) economic growth potential, World Economic Forum took into account factors which contribute to the current productivity.

But let's speak about economic competitiveness top. If to trust these standings, then the fact that countries like Tanzania, Namibia or Botswana, which have suffered hunger and civil wars until recently and do not have our aspirations and possibilities, are placed before us does not give a good account of ourselves.

However, we do not fight for competitive advantages anymore. We rely on comparative advantages. What God gave us: raw products, especially foods, cheap labour force. However, we have neither a competitive climate, nor laws to impose a performance in work and vocation of what was done, because we lack a competitive restriction.

On the other hand, Moldovans earn among lowest salaries. Much, very much below what workers in the European Union earn. This situation is normal as long as the efficiency rate is seven times better in the west of Europe than in Moldova. In spite of almost equal prices, a Moldovan is paid for his work about 20-fold less than a French or an Italian. Or some 6-fold less than a Pole or a Hungarian. We rank a last place in Europe with a monthly medium salary of less than 100 euros.

Certain economists say that all the bad will bring... the good. Being loyal to theory of comparative advantage, launched by classicists of political economy, they are not ashamed to write or say that sustenance salaries of Moldovans represent a terrible advantage. This is the theory. Let's see, however, what the practice shows us. We had failed to raise more than 700-800 million dollars from exports for years in a row.

We exceeded one billion dollars just in 2003, being however much below level of some countries such as Albania or Croatia. Collections from exports have grown since then, but they were much lower than collections from imports. The reason is that Moldovan products lack the best paid side in international trade: contribution of creativity.

So, competitiveness. Why do we need our comparative advantage then? It doesn't matter that we are a big exporter of wines and food products. Yes, this is an advantage that God gave us, but I do not think that the wine making is the ground of competitiveness and economic growth. What would be useful to produce or what products would go through competition both on domestic market, and on foreign market? This is not a simple question.

Many persons think that the state must invest in wine making sector. With all my respect, I am not confident that this would be the best solution. This is the problem of problems for us - what should we do, what should be the structure of Moldovan economy, structure which would allow us to compete abroad, taking into account our potential.

The fertile land is a wealth of ours and an important potential for Moldova for sure. However, lacking an increased productivity in agriculture, we should go in direction of services, don't you think? As for example, if a building is constructed on 0.1 hectares of land and several IT specialists work there, be sure that they will earn a day more than farmers earn a year. So, investments should go to this sector, to innovation, it means to branches where capital and human potential are predominant.

The entire structure of the old theory was broken. It is time of competitive advantages. It means that God gives opportunities, but not gifts. It is important what of opportunities that God gave us we have used.

The national economies were counting their "comparative advantages" till a couple of years ago: industries close to raw materials, abundant energy resources, cheap labour force. However, this was yesterday. We see today how these criteria are in the middle ground. The competitive advantage is in foreground now. The advantage that no nation uses the way God gave it, in raw condition, but it processes it with intelligence. Finland leads the competitiveness top, cooking a coffee which contains products with fewer raw materials (iron, steel, wood, plastics, energy resources) and more intelligence included in the final substance, with *Nokia* being the skin.

However, Moldova continues to hold the red light in Europe and the world because it does not have competitive advantages, advantages based on a modern work, and I think that we will not have competitive advantages soon.

Do we want efficiency? Do we want competitiveness? We are free to release individual initiative and personal risk. Or, the private initiative itself is the fundamental condition for prosperity of a society, the way classicists of economic liberalism had demonstrated. We must get rid of collectivist mentality, mentality which fuels an economic system whose burden is moving from a shoulder to another shoulder without being observed. Thousands of people with insufficient incomes have the illusion that they are economically safe under its used coverage. The illusion is the worst and most dangerous one.

Therefore, more action, incision and personal courage, these are ingredients of our success as society, being able to ensure our entry with equal rights in family of European nations in a farther future.

## **Banks punished**

Iurie Gotisan, October 25, 2005

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*Democracy and governing in Moldova  
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### **Authorities take commercial banks to task**

The bank system in Moldova has visibly developed the past years in spite of a not very favorable external environment. Indicators of financial position of commercial banks have remained relatively high, while year 2004 confirmed this evolution one more time. The nongovernmental credit rose by almost 50 percent. A boom of credits for individuals marked year 2004 and the nine months of 2005, as loans released to population rose by 44 percent and this evolution demonstrates the dynamic of development of the domestic bank system. However, the chief of state and prime minister described the contribution of commercial banks to development of the real sector of economy as poor, in spite of the stable situation of the bank system.

President Voronin urged commercial banks at the Investment Climate in Moldova forum of businessmen to reduce the interests on credits for enterprises. In turn, Premier Vasile Tarlev "has solicited" banks to lower the interests on credits in lei down to 15 percent by late 2005. However, it seems to us that both the chief of state and premier hurried up to demand the sudden reduction of bank interests on credits, and their demand probably lacks a deep analysis of the situation. We do not think that a 4-5 percent reduction demanded by Premier Tarlev in such a short period till late 2005 would have positive effects on economic system and on economy in general, at least at the beginning. Indeed, the market economy rules do not admit the direct involvement of the state in economy.

However, we will try to argue at least from two points of view and to say that the statements came in a hurry. Of course, a reduction of interest rates is needed, but, **first of all**, the economic theory says that such a sudden reduction would lead to a credit boom (especially of consumption credits), and this explosion would increase the inflation a lot. In addition, if such a high reduction of interests on credits is accepted now, the surplus of liquidity on monetary market would grow, and this liquidity exists now on market. In turn, the excess of liquidity would be observed for sure in the rise of prices of consumption products, and this growth would be visible in all sectors of economy.

Since the economy of Moldova is an economy of consumption, not of production (for the time being), the trade deficit and deficit of current account would grow on basis of the rise of consumption and consumption credits, and this is not bad at all costs. As for example, consumption credits increased sales of household appliances very much the past two years. Under these conditions, the growth pace of credits, especially of consumption credits, runs counter capacity of economy to react to expansion of the demand immediately, so that an external unbalance is registered on account of some massive imports. Branches that crediting should encourage, it means producers of consumption goods, are slowly developing.



As we have earlier said, a significant reduction of interests on credits would increase the consumption and resuscitation of some big inflationary tensions.

**Secondly**, money is also goods. Those who had attended political economy courses in institutions during the USSR period remembered this postulate for sure. If the price of some goods were dictated, then many people would be tempted to demand lower prices for all other goods. De facto, nobody tries now to dictate the prices, nor even for bread. Do you think that it is so easy with bank credits - suddenly by 5 percent within three months?

A reduction of interests is normal and necessary, but it must be gradual and differential. It means that interests on investment and production credits be lowered, but interests on consumption credits should remain unchanged for the time being. The market must follow its way. This way the economic system would avoid a deep crisis associated with high inflation rates. An overwhelmed inflation and a substantial depreciation of the national currency would be the consequences of such actions. Some states in Latin America demonstrated such evolutions in the 1980s, or some countries in Central Europe such as the Czech Republic or Poland did in the 1990s, when their payment incapacity associated with political implications in financial-bank system turned into the most serious inflation.

### **Businesspersons and banks - on different sides of barricades**

On the other hand, to be in the shoes of businessmen, we should mention that the European Bank for Reconstruction and Development has opened special credit lines cheap enough in several local banks. The EBRD takes an interest rate from 0.75 percent up to 5 percent from banks, while credits are released for 5-10 years. However, banks increase 2-3-fold the interest rate on credits granted to businesses and make them inaccessible for a long-term. If banks released credits for at least 10-12 percent, not 5 percent, we think that it would be easier to businesses that receive them to enlarge their activity, to finance their investment and production spending or to employ more people.

At the same time, we would also award victory to banks when they oppose the reduction of banks, since the very high arrears of enterprises towards banks or existence of an exaggeratedly large volume of non-modern credits would be one of reasons, which make the latter increase the interests as means to maintain a minimum liquidity of financial activity. We do not justify the construction of some sumptuous headquarters or exaggeratedly high salaries in bank sector, though they are not valid in the entire system, but we think that the bank sector has managed to avoid a system crisis in spite of all difficulties that it had to get through, and we would indicate the 1998 financial crisis as example in this regard.

The chief of state warned that an international bank will join the market and "would overturn" the interest policy of local banks. The idea of the president is not bad at all in general, but we do not think that the solution to attract a foreign bank would be the best one for reduction of interests, though the presence of a financial-bank institution from other country could be an example of crediting for local bank operators, while its assets would be several fold larger than assets of all banks in Moldova taken

altogether. As for example, the total assets of the bank system in Moldova (more than one billion dollars) are similar to assets of a bank based in the town of Bethesda, a suburb of Washington with about 60,000 residents.

However, let's remember the service of some foreign banks which had worked in Moldova such as the Turkish-Romanian Bank, the Greek bank that went bankrupt. Indeed, the presence of BCR or ProCredit, a special crediting institution with entire foreign capital, on domestic market does not mean that they contract credits for lower interests than on the entire system. In addition, the presence of an international bank on domestic market would mean that the entire profit would leave the country. It would be ideal to create a state-owned investment bank, an idea discussed for quite a long time, and we think that financial resources would be found. Remittances of Moldovans who work abroad could be used for the time being, and, of course, if the state promotes an adequate policy to attract these means.

We have said above that the bank system faces a surplus of liquidity, so that it does not know what to do. It is a paradox that banks do not fight for clients through reductions of interest rates under such conditions. Indeed, a true competition in the Moldovan bank system is impossible in such a conjuncture. The structure of Moldovan bank industry is very close to the structure of a collusive oligopoly.

We think that the problem is here. To be more clear, we mention that the five leading banks in the country perfectly understand each other regarding the price strategy. A true cartel was created on market. The other banks, the small ones (because we do not have medium banks), cannot meet the crediting demand of the economy. In addition, their credit portfolio is much worse than of big banks, and this requires the creation of additional reserves and disfavors the policy of small banks regarding reduction of crediting price. Thus, everything is in hands of big banks.

As a result, the structure of the Moldovan bank industry should change. The idea to open the market to big foreign banks is welcome. There were speculations last summer that Austria's Reiffesen Bank is interested to join the Moldovan market. On the other hand, there are "gossips" that the National Bank of Moldova is informally opposing (the lobby of big banks is the evident cause), saying that it unfits some interests. The chief of state is right in principle when he says that the entry of a big foreign bank would bowl over the cartel.

Probably this proposal of President Voronin is coming as a threat. This threat is a proof that the authorities know the undesire of big banks for a stronger competition. Nor the political interest is excluded here. Otherwise, the state would sell its majority package of 51 percent in the Savings Bank to a foreign bank long ago.

### **Instead of conclusions**

At the same time, if banks reduce the interests on credits, they would be tempted to lower the interests on deposits of population as well. In addition, they would have to ensure at least 2 percentage points over inflation rate on deposits to depositors. Imagine that the interest rate on deposits of population on bank system would be 6 percent, for example, while the inflation rate is 10 percent; there is a clear risk that

depositors could stop saving their money in banks. It is well known that bank deposits come from financial resources of population attracted on deposit accounts of banks. However, financial experts describe the money from bank deposits as "short". Finally, why should we demand cheap and long-term credits from banks since clients might withdraw their money at any moment, depending on interest rate on deposits and inflation rate? However, current trends of prices raise concern, if taking into account the exorbitant rise of fuels prices, which is reflected in most of consumption prices.

We do not believe that international financial organisations, the International Monetary Fund or the World Bank, would accept this state of things, it means the reduction of interest rates, since we know well that they are adepts of austere policies. A law would be the solution to this situation. It would be ideal if businessmen propose a draft law to the parliament, a law which would oblige the National Bank of Moldova to demand commercial banks to reduce the interests. BNM is the bank of banks, not of the state, being responsible only in front of the parliament. Thus, as a proverb says, the goat would be full and the cabbage would be whole.